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ABSTRACT

This report reviews the status of government agencies and operations that have been identified as at "high risk" for waste, fraud, abuse, and mismanagement; describes successful progress in some agencies; and looks at recent reform legislation. Six categories being targeted include accountability of defense programs, ensuring that all revenues are collected and accounted for, obtaining an adequate return on investments in information technology, controlling Medicare claims fraud and abuse, minimizing loan program losses, and improving management of federal contracts. In the area of loan program losses, the guaranteed student loan program cost $2.4 billion in losses in fiscal year 1994. The Department of Education is addressing some of the program's weaknesses by transferring some risks and financial costs to lenders and guaranty agencies, and is phasing out the guaranteed loan program and replacing it with a direct loan program. However, loan data continue to be unreliable, and a viable strategy is needed to prevent unscrupulous schools from participating in the new direct loan program. Five programs have made enough progress to have their high-risk designation removed. Legislative changes are moving toward a smaller, more efficient government that focuses on accountability and managing for results, such as the Government Performance and Results Act and the Chief Financial Officers Act. (JB)

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United States General Accounting Office

GAO

High-Risk Series

February 1995

An Overview

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GAO **United States**
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

February 1995

The President of the Senate
The Speaker of the House of Representatives

In 1990, the General Accounting Office began a special effort to review and report on the federal program areas we considered high risk because they were especially vulnerable to waste, fraud, abuse, and mismanagement. This effort, which has been strongly supported by the Senate Committee on Governmental Affairs and the House Committee on Government Reform and Oversight, brought much needed focus to problems that were costing the government billions of dollars.

In December 1992, we issued a series of reports on the fundamental causes of problems in designated high-risk areas. We are updating the status of our high-risk program in this second series. In this Overview report, we discuss the urgent need to continue addressing critical high-risk problems, covering such areas as Defense Department contract and inventory management, revenue collection operations, major lending programs, and oversight of tens of billions of dollars in contracts. We also introduce newly designated high-risk areas, such as serious and long-standing financial management weaknesses in Defense, growing fraudulent tax filings, and several critical information systems modernization projects that are plagued with problems.

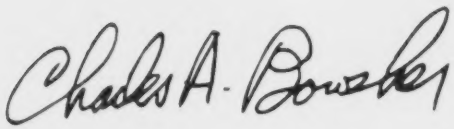
Overall, legislative and agency actions in response to our recommendations have resulted in progress toward resolving many high-risk problems. In five areas, such as the Pension Benefit Guaranty Corporation, improvement has been significant enough for us to remove their high-risk designation. In only three areas, Defense weapons systems acquisition and inventory management and the Internal Revenue Service's collection of delinquent receivables, has there been little progress.

In addition to efforts to address individual high-risk areas, the Congress has moved to address critical problems on a broader basis by passing the 1993 Government Performance and Results Act and, in 1994, expanding the Chief Financial Officers Act. These pieces of landmark legislation establish the framework to better manage and measure results of federal operations.

In addition to this Overview, the series includes a Quick Reference Guide (GAO/HR-95-2), which provides information on the 18 high-risk areas we have tracked over the past few years. For each area, the Guide summarizes the problems, root causes, progress, and outlook for the future; identifies a key GAO contact person; and provides a list of related GAO products. The series also includes separate reports for 10 areas, detailing continuing significant problems and resolution actions needed.

Copies of this report series are being sent to the President and the Republican and Democratic leadership of the Congress, committee chairs and ranking minority

members, all other members of the Congress, the Director of the Office of Management and Budget, and the heads of major departments and agencies.



Charles A. Bowsher
Comptroller General
of the United States

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Executive Summary

Many critical government operations are highly vulnerable to waste, fraud, abuse, and mismanagement. The government is needlessly losing billions of dollars and missing huge opportunities to achieve its objectives at less cost and with better service delivery. These vulnerabilities expose the government to future losses. Mitigating these losses is especially important at a time when the government faces large budget deficits. This report series updates our efforts to address high-risk problems and identifies further actions needed.

At the heart of high-risk situations is a lack of fundamental accountability, which has led to hundreds of management weaknesses throughout government, many persisting for years. These weaknesses have fostered an environment with inefficient processes that do not provide reliable information and that urgently need to be streamlined and improved. Moreover, almost all of the government's major departments and agencies have not been able to pass the test of an independent financial statement audit. This situation justifiably reinforces the public's low level of confidence in how the government manages their tax dollars.

This is not to say that no progress has been made. In fact, in 15 of the 18 high-risk areas, congressional and agency efforts have prompted long-needed improvements. In some areas, progress has been sufficient for us to remove the high-risk designation.

This report highlights:

- six broad current high-risk categories that will be the focus of our program over the next 2 years;
- progress achieved in most of the high-risk areas we have emphasized since our program's inception in 1990; and
- recent legislation establishing the framework needed to better manage and measure results of federal operations.

Current High Risks

Our focus over the next 2 years will be on six broad categories. Collectively, these high-risk areas affect almost all of the government's $1.25 trillion revenue collection efforts and hundreds of billions of dollars of federal expenditures.

Six Categories of High-Risk Focus

1. *Providing for Accountability and Cost-effective Management of Defense Programs*
2. *Ensuring All Revenues Are Collected and Accounted For*
3. *Obtaining an Adequate Return on Multibillion Dollar Investments in Information Technology*
4. *Controlling Medicare Claims Fraud and Abuse*
5. *Minimizing Loan Program Losses*
6. *Improving Management of Federal Contracts at Civilian Agencies*

Providing for Accountability and Cost-Effective Management of Defense Programs

While our military capabilities are unparalleled in the world today, Defense cannot accurately account for its more than $250 billion annual budget and over $1 trillion in assets worldwide. It also has been unable to adequately fix well-known areas of major vulnerability. These include

- holding inventory, valued by Defense at $36 billion, that is no longer needed for current operating requirements;
- disbursing $25 billion to vendors that cannot be matched to supporting documentation to determine if payments were proper;
- relying on contractors to voluntarily return hundreds of millions of dollars in overpayments; and
- paying billions of dollars in added costs when acquiring weapons systems.

These poor practices are draining resources that could be used to further enhance military readiness. At the heart of these problems is a long-standing culture that has not valued good financial management. No military service or major Defense component has been able to obtain a financial audit opinion because of hundreds of billions of dollars in assets not accounted for and countless failures in performing the most rudimentary bookkeeping tasks. The Secretary of Defense said it well: "We need to reform our financial management. It is a mess, and it is costing us money we desperately need."

Effective implementation of the landmark Chief Financial Officers Act throughout the Department of Defense is critical. We have

made numerous recommendations to strengthen Defense accountability and management. While Defense has acknowledged the severity of its financial management problems and established goals to correct them, it still lacks the realistic plans and expertise needed to accomplish those goals. These issues are discussed in more detail on pages 38 to 44.

Ensuring All Revenues Are Collected and Accounted for

Although responsible for collecting 98 percent of the government's revenues—currently $1.25 trillion annually—the Internal Revenue Service (IRS) has not kept its own books and records with the same degree of accuracy it expects of taxpayers. For the last 2 years, we have been unable to express an opinion on IRS' financial statements due to serious accounting and internal control problems.

In response to our audit reports, IRS has expressed its commitment to develop meaningful and reliable financial information and establish sound internal controls. However, IRS' financial management weaknesses are pervasive, have been repeatedly reported, and warrant prompt attention. IRS' financial systems are out of date, produce unreliable data on tax

receivables, and do not adequately control unauthorized access to taxpayer information. IRS' financial operations fail to perform some of the most basic accounting practices—reconciling collection deposits, assessing the collectibility of receivables, and ensuring that all transactions have been properly recorded to taxpayer accounts.

IRS is losing ground in collecting mounting tax receivables. Poor information systems are a major barrier to making decisions. Also, IRS has had difficulty in coping with rapidly increasing filing fraud. Fraudulent paper and electronic filings have flourished and, unless brought under control, heavy losses will continue—tens of millions of dollars annually. Problems related to collecting and accounting for revenues are discussed on pages 44 to 53.

Obtaining an Adequate Return on Multibillion Dollar Investments in Information Technology

Today's information technology offers unprecedented opportunities to improve the delivery of government services and reduce program costs. Using technology well is central to enhancing the information available to federal managers and the public. Unfortunately, the government has not been able to take full advantage of these opportunities. The result is wasted

resources, a frustrated public unable to get quality service, and a government ill-prepared to measure results and manage its affairs in a businesslike manner.

Despite an estimated $200 billion investment in the last 12 years, there is too little evidence of promised capabilities being delivered on time and within budget. For example:

- The largest component of the Federal Aviation Administration's $36 billion air traffic control modernization to improve air safety has had to be dramatically revamped.
- IRS' $8 billion Tax Systems Modernization, intended to overhaul the tax collection process, has experienced continuing delays and design difficulties.
- Defense's Corporate Information Management initiative, estimated to save billions of dollars by streamlining Defense's business operations in critical areas, has failed to meet program objectives.
- The National Weather Service effort to improve its weather prediction systems has experienced cost growth for its radar and satellite components and has lacked a systems architecture to guide the development and implementation of these and other components.

Problems in this area are discussed on pages 54 to 59.

Controlling Medicare Claims Fraud and Abuse

Medicare is undermined by flawed payment policies, weak billing controls, and inconsistent program management. Instances of scams, abuses, and fraud abound in the $162 billion program. Insurers have owed Medicare millions of dollars for mistaken payments. Moreover, to maximize profits, providers continue to exploit loopholes and billing control weaknesses.

Under current policy, the Congressional Budget Office projects Medicare payments will reach $380 billion a year by 2003. The Health Care Financing Administration has moved to counteract the program's abuses, but its overall management of these activities is not sufficient. Stronger controls are essential to deter a drain on taxpayer funds. See pages 60 to 63.

Minimizing Loan Program Losses

The federal government provides this country's largest source of credit. The government managed direct loan portfolios of $155 billion and had guaranteed loans totaling $699 billion at the end of fiscal year

1994. In fiscal year 1994 alone, lending agencies wrote off about $2.8 billion of direct loans and terminated for default $16.4 billion of guaranteed loans. Future costs to the government of tens of billions of dollars are anticipated.

This extraordinary exposure reinforces the need to effectively manage credit programs. Oftentimes a lender of last resort, federal credit programs will incur losses, but these costs can be reduced by overcoming management control problems.

- Improvements have been made by the Department of Agriculture in the $18 billion farm loan program, but the program incurred over $6 billion in losses from fiscal year 1991 through fiscal year 1994 and still has nearly $5 billion on the books in outstanding loans to farmers who are behind on loan payments. See pages 64 to 65.
- Between fiscal years 1991 and 1994, annual guaranteed student loan losses declined from $3.6 billion to $2.4 billion, due in part to improvements initiated by the Education Department. However, problems with school eligibility and the accuracy and availability of loan data could threaten the future delivery of Education's student financial aid. See pages 66 to 67.

- The Department of Housing and Urban Development (HUD), which insures some $400 billion in housing loans, guarantees more than $400 billion in outstanding securities, and spends $25 billion a year on housing programs, is currently the subject of numerous "reinvention" proposals; however, the agency must address fundamental internal control, management, staffing, and systems problems regardless of what changes are made. See pages 68 to 69.

Improving Management of Federal Contracts at Civilian Agencies

Civilian agencies rely on contractors to provide goods and services costing tens of billions of dollars a year. It is critical to ensure that the government gets what it pays for and that contractors' work is done at reasonable cost. But this has not always been the case.

- The Department of Energy has allowed its management and operating contractors extensive latitude in spending $15 billion annually, and it has not required contractors to have financial audits despite continuing disclosures of abuse and poor management. As a result, the government is not adequately protected. See pages 70 to 72.
- Ineffective oversight by the National Aeronautics and Space Administration

(NASA), which spends about $13 billion a year under contract, has resulted in cost growth and schedule slippage in completing large space projects. See pages 72 to 73.

- Contract management problems in the Environmental Protection Agency's (EPA) multibillion dollar Superfund hazardous waste cleanup program have provided contractors too little incentive to control costs. See pages 74 to 75.

High-Risk Program Successes

In 15 of 18 high-risk areas we have followed, there has been progress in attacking root causes of problems. In 5 areas, enough progress has been made to remove their high-risk designation, although we will continue to monitor their status.

High-Risk Successes

The ***Bank Insurance Fund*** has gone from a deficit position at the end of 1991 to a $17.5 billion surplus as of June 1994. (See p. 26).

The ***Resolution Trust Corporation*** has resolved 743 failed savings and loan institutions and disposed of $432 billion, or 93 percent, of their assets. (See p. 28).

The ***Pension Benefit Guaranty Corporation*** has significantly improved management controls and expects that new legislation will lower underfunding in plans it insures and its deficit. (See p. 30).

The State Department's ***Management of Overseas Real Property*** has been revamped, significantly reducing vulnerabilities. (See p. 32).

The ***Federal Transit Administration's Grant Management*** has substantially improved the process to oversee and enforce its $4.6 billion grant program. (See p. 33).

Progress in each of the 18 areas is discussed in the accompanying Quick Reference Guide (GAO/HR-95-2).

Importance of Recent Legislative Framework for Management Reform

While specific actions have been identified to fix individual high-risk areas, broader, more fundamental problems in government also need to be addressed. Calls for civil service reform, government reorganization, privatization, and devolution of functions and programs to states and local governments are all areas worth exploring. Such changes may lessen the government's vulnerability, and we are working with the Congress on these and other broad reforms.

It is important to move toward a smaller, more efficient government that focuses on accountability and managing for results. To successfully achieve these goals, accurate and reliable cost information and performance data are absolutely essential. The Government Performance and Results Act (GPRA) and the Chief Financial Officers (CFO) Act help provide the critical impetus for generating such management information.

GPRA establishes pilot projects to define expected results up front and then measure their attainment. This is intended to move decisionmakers from a focus on inputs and spending to one on outcomes and results. The CFO Act, as expanded by the 1994 Government Management Reform Act,

establishes a financial management leader in each major department, requires annual audited financial statements for all major departments and agencies for fiscal year 1996, and mandates the development of cost information and the modernization of financial systems.

Effectively implementing such landmark legislation should go a long way toward solving high-risk problems and restoring citizens' confidence in government. It is essential that agencies adhere to the statutory deadline for having audited financial statements and that basic accountability objectives are met. As part of our continuing evaluation of high-risk areas, we will work with the Congress and the Executive Branch to promote effective implementation of the CFO Act and GPRA.

These issues are discussed in more detail on pages 76 to 86.

Calling Attention to High-Risk Areas

Over 12 years ago, in the face of seemingly endless accounts of control breakdowns and program failures, the Congress passed the Federal Managers' Financial Integrity Act of 1982. The act required federal managers to evaluate their internal control and accounting systems and to correct problems.

Since 1983, heads of the 18 largest federal agencies have identified well over 3,000 weaknesses and reported progress in resolving them. Yet, our audits have shown that similar problems surface over and over, and that the condition of controls and accounting systems remains very poor.

In November 1989, we reported[1] that fraud, waste, abuse, and mismanagement continued to cost the taxpayers billions of dollars, rendered programs ineffective, and painted a picture of federal agencies unable to manage their operations or fully account for their assets. It was during this time that the American public learned of a scandal at HUD, where serious deficiencies had gone unabated for many years.

[1]Financial Integrity Act: Inadequate Controls Result in Ineffective Federal Programs and Billions in Losses (GAO/AFMD-90-10, Nov. 28, 1989).

In 1990, we established our high-risk program, placing special attention on 14 areas considered to be especially vulnerable.

The Original 14 High-Risk Areas

Resolution Trust Corporation

Internal Revenue Service Receivables

Management of Seized and Forfeited Assets

Medicare Claims

Pension Benefit Guaranty Corporation

Guaranteed Student Loans

State Department Management of Overseas Real Property

Defense Inventory Management

Defense Weapons Systems Acquisition

NASA Contract Management

Farmers Home Administration's Farm Loan Programs

Superfund Program Management

Federal Transit Administration Grant Management

Department of Energy Contract Management

Since 1990, we have added four areas.

High-Risk Area	Date Added
Bank Insurance Fund	*February 1991*
Managing the Customs Service	*February 1991*
Defense Contract Pricing	*December 1992*
HUD	*January 1994*

In December 1992, we issued a series of reports on the designated areas. We reported that some agencies were openly recognizing high-risk problems and developing and implementing corrective actions. We also reported that legislation needed to address certain individual high-risk areas had been passed, some agencies had developed sound plans for correcting problems, and a number of financial management improvements had been achieved.

Despite these advances, major problems persisted and the danger of billions of dollars in losses remained. Since the 1992 series was issued, we have continued to devote substantial audit effort to high-risk areas to press for further improvements.

Since 1989, the Office of Management and Budget (OMB) also has had a high-risk program, which today encompasses 57 areas. As reported in the President's fiscal year 1996 budget submission, OMB has also found that the concentrated attention resulting from such an effort has helped spark a number of important improvements. In our most recent review of OMB's high-risk program,[2] we agreed in most cases with OMB's evaluation of the progress made by agencies to address identified problems.

[2]OMB's High-Risk Program: Comments on the Status Reported in the President's Fiscal Year 1995 Budget (GAO/AIMD-94-136, Sept. 20, 1994).

The High-Risk Program Successes

After 5 years, the high-risk program continues to demonstrate its value in prompting long-needed improvements. Significant efforts by agencies, coupled with legislation and congressional oversight, have addressed many identified deficiencies. Congressional hearings have been particularly important in defining solutions and bringing about changes. For some areas, we are removing the high-risk designation. Others are on the right path to resolution, while only three areas have shown little improvement.

Five Areas Show Significant Progress

In five areas, legislative and agency actions in response to our recommendations have resulted in improvements significant enough for us to remove their high-risk designation.

High-Risk Designation Removed

Bank Insurance Fund

Resolution Trust Corporation

Pension Benefit Guaranty Corporation

State Department Management of Overseas Real Property

Federal Transit Administration Grant Management

We will, however, continue to closely monitor these areas. If significant problems again arise, we will consider returning the area to the high-risk program. Additional information on each of these areas is provided in the Quick Reference Guide (GAO/HR-95-2).

We put the **Bank Insurance Fund** on our high-risk list because unprecedented numbers of bank failures and insurance losses in the late 1980s and early 1990s had depleted the Fund's reserves. These failures

resulted from the banking industry's shift to increasingly risky lending activities in response to a shrinking customer base and increased competition. Banks' lending risks were exacerbated by weak internal controls, flawed corporate governance systems, and lax regulatory supervision. By year-end 1991 the Fund was in a deficit position.

In various reports and testimonies, we recommended that the Congress rebuild the Fund and put safeguards in place to improve regulation and minimize future losses to the Fund. These safeguards included management and auditor reporting on the effectiveness of internal controls, independent audit committees, safety and soundness standards, prompt corrective actions to minimize Fund losses, and accounting reforms to ensure reliable financial reports.

The Congress responded by passing several pieces of legislation. The Omnibus Reconciliation Act of 1990 removed caps on premium increases and gave the Federal Deposit Insurance Corporation (FDIC) increased flexibility to set premium rates. The FDIC Improvement Act of 1991 provided for rebuilding the depleted deposit insurance fund and required significant corporate

governance, regulatory, and accounting reforms. These reforms, which have largely been implemented by FDIC and others, address the serious weaknesses that contributed to earlier record bank failures.

The rapid rebuilding of the Fund's reserves, which stood at $17.5 billion at June 30, 1994, has substantially reduced the Fund's risks. We are currently performing the 1994 financial audit of the Fund and will be issuing our report in March 1995.

The **Resolution Trust Corporation** (RTC) was created in August 1989 to resolve hundreds of failed savings and loan institutions and dispose of their assets. Although original estimates indicated that RTC would need $50 billion to close known failed thrifts, cost estimates escalated rapidly. By May 1990, the number of known failed thrifts had increased and RTC's most conservative cost estimates had grown to nearly $90 billion. In addition, RTC faced significant risks associated with contracting out the management and disposition of failed thrift assets worth hundreds of billions of dollars. As a result, RTC was part of our high-risk program almost from the Corporation's inception.

We made numerous recommendations in reports and testimonies over the years aimed at reducing the total thrift cleanup costs. We called for providing RTC with adequate and timely funding for failed thrift closures and for management reforms designed to improve RTC's asset disposition, contracting, and financial management activities. We also pointed to the need for RTC to better estimate the value of failed thrift assets so that the Congress would have the best possible information on which to base its funding decisions.

In response, the Congress passed several laws that provided RTC with additional funding, mandated that RTC implement specific management reforms, and required the establishment of an interagency transition task force with specific responsibilities to facilitate the transfer of RTC's workload, personnel, and operations to FDIC by January 1996. For its part, RTC made numerous improvements in its estimating processes, internal controls, and financial management systems in order to provide more reliable, auditable cost data. As a result, we have been able to attest to the accuracy of RTC's balance sheet beginning in 1991 and its financial statements since that time. RTC has also fully implemented most of

the congressionally mandated reforms and continues to work on the others. Finally, RTC and FDIC have established a task force that has begun to work on transition issues.

Although the transition remains an area of concern, RTC no longer poses the risk it once did. As of November 1994, RTC had completed the resolution of 743 failed thrifts; disposed of $432 billion of the $463 billion in assets from those failed thrifts; and made notable improvements in its disposition, contracting, and management activities. We are currently performing the 1994 financial audit of RTC and will report the results in mid-1995.

In December 1992, we reported that the **Pension Benefit Guaranty Corporation's** (PBGC) weak financial condition threatened the program's viability. In 1993, management deficiencies hindered PBGC's ability to effectively assess and monitor its financial condition. Its single-employer fund had a $2.9 billion deficit, and it faced $71 billion in underfunding in the ongoing plans it insured.

To reduce these threats, we recommended a combination of legislative actions and strengthened oversight and enforcement efforts. In particular, we supported

legislation to strengthen funding standards and make the variable rate premium more risk related. We also recommended that PBGC correct significant system and control weaknesses in its liability estimation and premium and accounting operations.

PBGC substantially improved its internal controls for estimating its liability for future benefits, enabling us for the first time to express an opinion on its 1992 balance sheet. Also on December 8, 1994, the Congress passed the General Agreement on Tariffs and Trade (GATT) which contains provisions to strengthen minimum funding standards and phase out the cap on variable rate premiums paid by underfunded defined benefit pension plans. We reported that most companies with underfunded pension plans will put more money into their plans. The agency estimates that these provisions will lower the underfunding in plans it insures and reduce the deficit in its single-employer fund.

Congressional and agency actions should reduce PBGC's exposure to losses and, correspondingly, the risk to the federal government. We are currently working on the 1994 financial audit and will issue our report in March 1995.

We put the **State Department's management of overseas real property** on our high-risk list because of insufficient maintenance of facilities, lax oversight of overseas post operations, inadequate information systems, and poor planning. These problems had resulted in deteriorated facilities, increased costs, and questionable managerial decisionmaking.

In response, State's actions included establishing priorities for construction projects based on specific criteria, better evaluating contractors' performance, hiring additional qualified staff, surveying the maintenance conditions of posts, streamlining and updating housing standards, and improving information systems. Related State initiatives underway include:

- conducting global maintenance surveys at over 170 overseas posts and establishing 2 regional maintenance assistance centers;
- implementing a facilities evaluation and assistance program;
- implementing an information resource management system and upgrading the real estate management system; and
- conducting financial audits at a number of overseas posts.

These initiatives significantly reduce the overseas property management program's vulnerabilities.

The **Federal Transit Administration's (FTA) grant management** was on our high-risk list because, until 1993, FTA focused more on awarding grants than on ensuring their proper use. Oversight was superficial and inconsistent, and FTA seldom used its enforcement powers to compel grant recipients to fix problems, even those that were long-standing.

We made numerous recommendations that focused on, among other things, ensuring that grant recipients have adequate management systems, strengthening reviews of recipients, and linking awards of grant funds to compliance with rules. In particular, we recommended that FTA withhold funds from grantees that did not complete corrective actions or were not in compliance with existing grant requirements.

Over the past few years, FTA has made substantial improvements in its process to oversee its $4.6 billion grants program, including organizational changes, increased oversight staff levels, and better training. FTA

has made a concerted effort to change the attitudes of its oversight staff and grantees towards safeguarding federal funds. FTA has gone from relying primarily on grantee certifications of compliance to implementing various initiatives and systems that, over time, should instill a more proactive approach to its grant management, oversight, and enforcement responsibilities. Most importantly, FTA has recently used its most powerful enforcement tool—withholding funds—to sanction grantees found to be mismanaging their programs.

FTA is in the process of implementing its improvement plan, but we believe that as these initiatives are carried out, the risk associated with the FTA grant program will continue to decrease.

Remaining Programs Show Mixed Results

For the remaining 13 high-risk areas,[1] agencies have made varying degrees of progress in designing corrective action plans and are in different stages of implementing those plans. For 10 areas, we have seen a genuine commitment to improve.

[1]The titles of some of these high-risk areas have been changed slightly to reflect the current focus of coverage.

Areas Making Progress Toward Improvement

Defense Contract Management
Medicare Claims
Farm Loan Programs
Student Financial Aid
Managing the Customs Service
Department of Housing and Urban Development
Department of Energy Contract Management
NASA Contract Management
Superfund Program Management
Asset Forfeiture Programs

In the remaining three areas, agencies have made little progress.

Areas Making Little Progress Toward Improvement

Defense Inventory Management
Defense Weapons Systems Acquisition
Internal Revenue Service Receivables

The high-risk program clearly has had a valuable impact and we will continue to focus on all 13 of these areas in the future. The following section, which discusses our future plans for the high-risk program, highlights problems remaining in the 13 areas and introduces newly identified areas.

GAO's High-Risk Focus

Current High-Risk Focus

Providing for Accountability and Cost-effective Management of Defense Programs

Ensuring All Revenues Are Collected and Accounted For

Obtaining an Adequate Return on Multibillion Dollar Investments in Information Technology

Controlling Medicare Claims Fraud and Abuse

Minimizing Loan Program Losses

Improving Management of Federal Contracts at Civilian Agencies

These 6 categories encompass the 13 areas being carried over and 7 newly added areas. All involve billions of dollars of taxpayers' money and will require a concerted effort to reduce significant risks.

Providing for Accountability and Cost-Effective Management of Defense Program

Defense is accountable for more than $1 trillion in assets and, in fiscal year 1994, spent $272 billion—approximately 50 percent of the government's discretionary spending in fiscal year 1994. However, many of Defense's management systems and practices are inadequate for safeguarding its assets or achieving its missions in the most cost-effective manner.

Recently, concerns have been raised about the current state of combat readiness. While the link to accountability has not often been drawn, funds lost through waste, fraud, abuse, and mismanagement are unavailable for training and equipment repairs. Defense has initiated actions to address most of its management problems, but the problems are all still far from being resolved. Defense's high-risk management problems fall in four areas:

High-Risk Defense Management Problems

Financial Management
Contract Management
Weapons Systems Acquisition
Inventory Management

Financial Management

Defense's financial management systems, practices, and procedures continue to be hampered by significant weaknesses.[1] This situation is the worst in government and is the product of many years of neglect. According to former Secretary of Defense Les Aspin:

"Accounting, business-type efficiency, and indirect support functions were secondary considerations of top DOD leaders...The [DOD] financial management community adapted to shortcomings and lacked a sense of urgency for correcting them."

In presenting the fiscal year 1995 budget, Secretary of Defense William Perry said:

[1]Financial Management: Financial Control and System Weaknesses Continue to Waste DOD Resources and Undermine Operations (GAO/T-AIMD/NSIAD-94-154, Apr. 12, 1994).

"[O]ur financial management...is a mess, and it is costing us money we desperately need."

Following are just a few examples of Defense's financial management problems.

- While over $400 billion in adjustments were made to correct errors in Defense reported financial data for fiscal years 1991 through 1993, the resulting statements were still not reliable.
- Vendors were paid $29 billion that cannot be matched to supporting documentation to determine if payments were proper.[2]
- An estimated $3 million in fraudulent payments were made to a former Navy supply officer for over 100 false invoice claims, and approximately $8 million in Army payroll payments were made to unauthorized persons, including 6 "ghost" soldiers and 76 deserters.[3]

While Defense has acknowledged the severity of its financial management problems and established goals for their correction, it still lacks realistic plans and the necessary expertise. A key contact for this area is identified on page 87.

[2]Financial Management: Status of Defense Efforts to Correct Disbursement Problems (GAO/AIMD-95-7, Oct. 5, 1994)

[3]GAO/T-AIMD/NSIAD-94-154

Contract Management

Despite reduced levels of reported defective contract pricing, long-standing contractor cost estimating problems continue, and other contract management problems have emerged. As a result, significant risks remain.

- Serious control weaknesses continue to result in numerous and large erroneous, and in some cases fraudulent, payments to defense contractors. During one 6-month period in fiscal year 1993, contractors returned to the government $751 million, and in fiscal year 1994, they returned $957 million, most of which appears to have been overpayments detected by the contractors.
- Contractors' systems for charging costs to the government continue to result in contractors' billing for, and Defense paying for, large unallowable amounts. From fiscal years 1991 to 1993, Defense auditors questioned about $3 billion in contractor overhead charges.

The recent emphasis on acquisition reform, including passage of the Federal Acquisition Streamlining Act of 1994, is a positive step toward strengthening the acquisition system. However, Defense must sustain efforts to ensure the integrity and fairness of its

contracting and procurement processes. This must include eliminating sizable and numerous overpayments to its contractors and aggressively dealing with contractors to ensure that long-standing deficiencies in cost-estimating systems are corrected.

More information on these contracting issues is provided in **Defense Contract Management** (GAO/HR-95-3).

Weapons Systems Acquisition

Defense is committed to reforming its major weapons acquisition process (involving about $80 billion a year) and has begun to reassess many of its most expensive weapon programs for opportunities to cutback to meet anticipated shortfalls in funding. Defense has also initiated reforms to address weapons systems acquisition issues since the inception of our high-risk program. However, pervasive problems, including (1) unreliable cost data, (2) unrealistic schedule estimates, (3) unaffordable program plans, and (4) contracting for weapon systems before needed technology is available, continue to add billions of dollars to acquisition costs.

Both Defense and the Congress have initiated actions that attempt to address

these serious problems. Defense has implemented a number of long-standing recommendations and has adopted an acquisition strategy that calls for proving technologies before incorporating them into the procurement process. In October 1994, the Congress legislated changes in the acquisition process and has also directed a reevaluation of the military services' roles and missions and the most cost-effective mix of weapons.

However, it is too early to assess the effectiveness of these acquisition reform efforts. Defense must quickly provide the regulations needed for implementing the recently enacted acquisition reform law. Successful reform will also require continuing strong congressional support.

As part of this high-risk series, we are issuing a separate report on **Defense Weapons Systems Acquisition** problems and additional needed improvements (GAO/HR-95-4).

Inventory Management

Defense's inventory management practices continue to result in billions of dollars in unneeded stock. Even after Defense disposed of unneeded inventory costing

$43 billion[4] over the last 3 years, it still holds items valued at $36 billion (or 47 percent of its total current inventory) that are not needed for current operating requirements or war reserves. While Defense has done some testing of new procedures in a few areas, such as prime vendor delivery of medical supplies, overall it has made little progress. Defense must aggressively work to change its inventory management culture so that it can achieve higher levels of readiness in the future using fewer dollars. In addition, congressional oversight will be necessary to maintain Defense's focus on these problems.

A separate report on **Defense Inventory Management** provides more information on this problem and additional needed improvements (GAO/HR-95-5).

Ensuring All Revenues Are Collected and Accounted for

Fair and equitable administration of tax laws demands that the government collect what it is owed. Yet, with annual collections currently at $1.25 trillion, IRS and Customs, the government's principal revenue collectors, continue to be unable to adequately account for and collect all that is due the government. The result is the

[4]We estimate that this inventory had a value of $914 million.

potential loss of billions of dollars in revenue.

High-risk revenue collection problems fall in four areas.

High-Risk Revenue Collection Problems

IRS Financial Management
IRS Receivables
Filing Fraud
Customs Service Financial Management and the Asset Forfeiture Program

IRS Financial Management

IRS' significant financial management weaknesses cause errors in taxpayer accounts and an inability to adequately account for collection operations—bookkeeping problems IRS would not accept from taxpayers. IRS' systems are antiquated and were not designed to provide the meaningful and reliable financial information needed to effectively manage and report on IRS' operations.

Our financial audits have highlighted a wide range of problems with the quality of IRS' revenue information, internal controls over billions of dollars of assets, and unauthorized access to taxpayer information.[5] Although efforts are under way to address recommendations from our 1992 financial audits, as of May 1994, IRS had completed action on only 4 of the 44 recommendations we made.

In our audit of IRS' fiscal year 1993 financial statements, we found

- unreliable data on its estimated $71 billion of valid accounts receivable (having an estimated collectable amount of $29 billion), which adversely impacted IRS' collection ability;
- over $90 billion of transactions that had not been posted to taxpayer accounts; and
- the inability to identify the amount of excise and social security taxes collected, resulting in billions of dollars of subsidies to recipient trust funds.

IRS' serious, long-standing, and pervasive financial management problems hamper the

[5]Financial Audit: Examination of IRS' Fiscal Year 1992 Financial Statements (GAO/AIMD-93-2, June 30, 1993) and Financial Audit: Examination of IRS' Fiscal Year 1993 Financial Statements (GAO/AIMD-94-120, June 15, 1994).

effective collection of revenues and preclude the preparation of auditable financial statements. Without adequate, reliable information about noncompliant and delinquent taxpayers, IRS cannot measure the effectiveness of its enforcement and collection programs. A key contact for this area is identified on page 87.

IRS Receivables

Meanwhile, tax receivables continue to grow. In some respects, the problem of collecting IRS receivables is worse today than it was 5 years ago when we designated this as a high-risk area.

Between 1990 and 1994, the reported inventory of tax debt increased from $87 billion to $156 billion. Coupled with this growth is another troubling fact. By 1994, annual collections of delinquent taxes had declined from $25.5 billion to $23.5 billion.

IRS' tax receivable collection is hampered by inaccuracies in records needed for strategically planning and making decisions on collection cases and by a lack of information to determine the optimum size and mix of staff for collection. Other impediments include a lengthy, antiquated, and rigid collection process and

decentralized lines of responsibility and accountability. It is also difficult to balance collection efforts with the need to protect taxpayer rights.

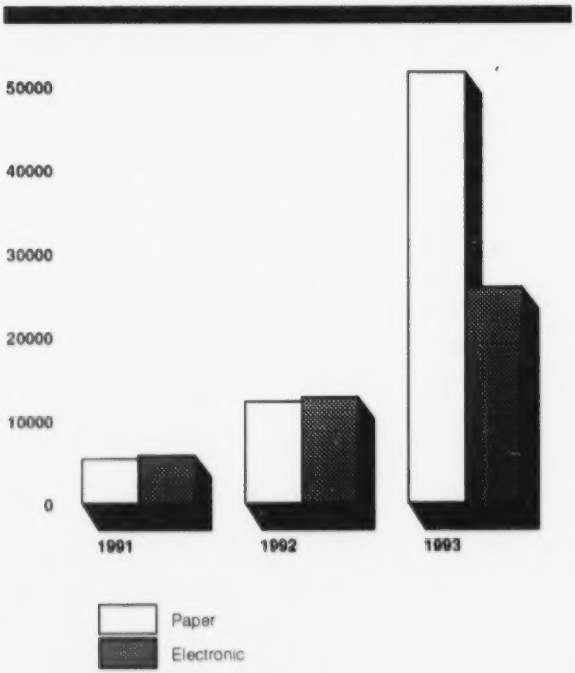
Additional information on problems with IRS **Receivables** is contained in a separate report being issued as part of this high-risk series (GAO/HR-95-6).

Filing Fraud

Another high-risk area for IRS is filing fraud. In the past several years, detected filing fraud for both paper and electronic filing programs has doubled or tripled annually as shown below in figure 1.[6]

[6]IRS Automation: Controlling Electronic Filing Fraud and Improper Access to Taxpayer Data (GAO/T-AIMD/GGD-94-182, July 19, 1994).

Figure 1: Fradulent Returns Detected



During the first 6 months of 1994, IRS identified about 34,700 fraudulent paper returns and 24,000 fraudulent electronic returns—increases of 151 percent and 52 percent, respectively, over the same period a year earlier. Thus, the upward trend continues.

Based on detected schemes alone, IRS has acknowledged the government loses tens of millions of dollars to refund schemes annually. A key contact for this area is identified on page 88.

Customs Service Financial Management and the Asset Forfeiture Program

With responsibility for about $20 billion in revenues, Customs is an important collector for the government. However, our 1992 high-risk report pointed to major weaknesses in Customs' management and organizational structure that diminished the agency's ability to detect trade violations on imported cargo; collect applicable duties, taxes, fees, and penalties; control financial resources; and report on financial operations.

Since that report, Customs has taken several actions to address these problems, including revising its planning process, improving controls over identification and collection of revenues owed, aggressively pursuing delinquent receivables, and embarking on an agencywide reorganization plan. Although these improvement efforts will require sustained management attention, they are properly focused and should reduce Customs' risks in the general management arena. Therefore, we are narrowing the

scope of our high-risk work at Customs to focus on its financial management problems. More information on **Managing the Customs Service** can be found in the Quick Reference Guide (GAO/HR-95-2).

Despite other improvements, Customs still needs to make significant additional efforts to correct its financial management and internal control systems weaknesses. Our audits of Customs' financial statements for fiscal years 1992 and 1993 disclosed that the agency had not yet fully resolved many of the financial management problems that we reported earlier.[7] Although efforts are underway to address recommendations from our fiscal year 1992 financial statements audit, as of May 1994, Customs had completed actions on only 11 of the 54 recommendations we made. Our financial audit for fiscal year 1993 found that Customs had not implemented controls, systems and processes to reasonably ensure that

- carriers, importers, and their agents complied with trade laws. As a result, revenue owed to the federal government may not have been identified and quotas and

[7]Financial Audit: Examination of Customs' Fiscal Year 1992 Financial Statements (GAO/AIMD-93-3, June 30, 1993) and Financial Audit: Examination of Customs' Fiscal Year 1993 Financial Statements (GAO/AIMD-94-119, June 15, 1994).

other legal restrictions may have been violated. Moreover, important trade statistics may not be reliable.

- sensitive data maintained in its automated systems, such as import inspection criteria and law enforcement data, were adequately protected from unauthorized access and modification.
- full accountability for its assets and the use of its appropriated funds were provided, or the costs of its programs and computer modernization efforts were reliably determined.

Customs also needs to address problems in its asset forfeiture program. We put both Customs' and the Justice Department's asset forfeiture programs on our original high-risk list because the programs—with inventories valued at almost $2 billion in 1994—focused more on taking property away from criminals and less on managing property taken. Both agencies have since initiated management and systems changes to improve program operations. However, our audits of Customs' fiscal years 1993 and 1992 financial statements have also revealed serious weaknesses in key internal control and systems that affected Customs' ability to control, manage, and report the results of its seizure efforts, including accountability and

stewardship over property seized. As a result, tons of illegal drugs and millions of dollars in cash and other property have been vulnerable to theft and misappropriation. For instance, in our fiscal year 1993 audit, we found that

- seized asset inventory records contained information on drugs that had been transferred to other agencies as early as 2 years before and did not show thousands of pounds of drugs that Customs was still holding; and
- physical security was weak at 20 of the 21 facilities we visited. Over the past several years, drugs and property have occasionally been stolen from Customs storage facilities. For example, in fiscal year 1993, thieves broke into a Customs facility and stole 356 pounds of cocaine.

Customs is taking action to address the internal control and systems problems; however, these efforts are in various stages of development.

Additional information on **Asset Forfeiture Programs** can be found in a separate report issued as part of this series (GAO/HR-95-7).

Obtaining an Adequate Return on Multibillion Dollar Investments in Information Technology

Huge, complex, and expensive computer modernizations are under way across the federal government to replace older generation automated information processing. Many of these long-term, multibillion dollar efforts are intended to harness information technology's power to provide agencies better capability to produce higher quality services tailored to the public's changing needs and delivered more effectively, faster, and at lower cost.

Yet, after spending more than $200 billion on information management systems during the last 12 years, project after project continues to lag behind schedule, consistently fails to provide intended mission benefits, and exceeds estimated costs by hundreds of millions of dollars.

Successful automation projects are more often the exception than the rule. As a result, critical financial, program, and management information systems remain largely incompatible, costly to operate and maintain, and woefully inadequate in meeting current users' needs.

To reduce costs, increase service, and raise productivity, information systems projects should not simply automate existing

inefficient or ineffective processes. Rather, functional processes should first be simplified, redirected, and reengineered. Information technology, however, is often procured as the fix to outdated, inefficient procedures before new work processes and organizational structures have been adequately designed or decided on.

We are adding to our high-risk list four multibillion dollar information technology initiatives because they experienced past failure, involve complex technology, or are critical to agencies' missions. Key contacts for these initiatives are identified on page 87 and 88.

High-Risk Information Technology Initiatives

Air Traffic Control Modernization
IRS' Tax Systems Modernization
Defense's Corporate Information Management Initiative
National Weather Service Modernization

Air Traffic Control Modernization

The air traffic control (ATC) modernization project covers all parts of the $36 billion Federal Aviation Administration (FAA) effort to overhaul the nation's air traffic control system and includes the remainders of the Advanced Automation System, components of which were canceled, replaced, and/or restructured. That system failed because FAA did not recognize the technical complexity of the effort, realistically estimate the resources required, adequately oversee its contractors' activities, or effectively control system requirements.[8]

[8]Advanced Automation System: Implications of Problems and Recent Changes (GAO/T-RCED-94-188, Apr. 13, 1994).

IRS' Tax Systems Modernization

Through fiscal year 1995, IRS will have spent or obligated over $2.5 billion on its $8 billion Tax Systems Modernization (TSM) initiative to automate selected tax processing functions. Yet, the overall design for TSM is still incomplete and IRS is continuing to automate existing problem-plagued functions with limited understanding of whether or how different systems will eventually connect to improve tax processing overall.[9] Given budget constraints and the risks involved, the Congress reduced IRS' fiscal year 1995 budget request by $339 million, and IRS has agreed to establish the needed business and technical foundation to achieve TSM's goals and objectives.

Defense's Corporate Information Management Initiative

The Corporate Information Management (CIM) initiative was estimated by Defense to save billions by streamlining Defense Department operations and managing resources more effectively; however, results to date have been mixed. Defense has largely been consumed with trying to pick the best of its hundreds of existing automated systems and standardizing their use across

[9]Tax Systems Modernization: Status of Planning and Technical Foundation (GAO/T-AIMD-GGD-94-104, Mar. 2, 1994).

military components.[10] As a result, Defense is spending some $3 billion annually to develop and modernize automated information systems, while major Defense business processes supported by these systems—such as personnel, payroll, inventory management, supply distribution, and contract administration—have not been examined for process reengineering opportunities.

National Weather Service Modernization

Although the National Weather Service's program to modernize its weather observing, information processing, and communications systems was originally expected to be completed in 1994, it is now estimated to not be completed until at least 1999. Also, the system that is to be the centerpiece of the modernization has recently experienced design problems and is being restructured. Additionally, the many systems comprising the modernization have long proceeded without the benefit of an overall architecture to guide their design, development, and evolution. This has negatively affected the modernization's cost

[10]Defense Management: Stronger Support Needed for Corporate Information Management Initiative to Succeed (GAO/AIMD/NSIAD-94-101, April 1994); Defense ADP: Corporate Information Management Must Overcome Major Problems (GAO/IMTEC-92-17, September 1992).

and performance by requiring additional resources to acquire, interconnect, and maintain hardware and software.[11]

In addition to focusing on these four high-risk initiatives, we are working with (1) the Congress to amend the Paperwork Reduction Act to provide a leadership structure for, and strengthen the management of, the government's information technology resources and (2) the Executive Branch on new guidance designed to bring into the government strategic information management "best practices" that successful organizations, public and private, have used to improve mission performance.[12] These are important steps toward ensuring that the federal government obtains an adequate return on its information technology investments.[13]

[11]Weather Forecasting: Systems Architecture Needed for National Weather Service Modernization (GAO/AIMD-94-28, Mar. 11, 1994).

[12]Executive Guide: Improving Mission Performance Through Strategic Information Management and Technology (GAO/AIMD-94-115, May 1994).

[13]Government Reform: Using Reengineering and Technology to Improve Government Performance (GAO/T-OCG-95-2, Feb. 2, 1995) and Paperwork Reduction Act: Reauthorization Can Strengthen Government's Management of Information and Technology (GAO/T-AIMD/GGD-95-80, Feb. 7, 1995).

Controlling Medicare Claims Fraud and Abuse

Medicare is one of the fastest growing programs in the federal budget. In fiscal year 1994 the government spent over $440 million a day, or about $162 billion, on Medicare. CBO estimates that, under current policy, Medicare spending will reach about $380 billion a year by 2003. The portion of Medicare spending attributable to waste, fraud, and abuse is difficult to quantify; however, health care experts have estimated that 10 percent of national health spending is lost to these practices. Even a lesser percentage, if applied to the $162 billion Medicare program, is a devastating amount and becomes even more devastating as the program grows.

The Health Care Financing Administration (HCFA) has made a number of regulatory and administrative changes aimed at correcting flawed payment policies, weak billing controls, and deficient program management. For example, in 1993, HCFA raised the standards for contractor performance regarding analyses of payment data to identify excessive spending. In 1994, the agency awarded a contract for developing a national automated claims processing system intended to replace the many systems currently operating. Through these efforts, using modern data analysis

techniques and greater uniformity in claims processing, HCFA expects to reduce Medicare's inappropriate payments. However, these improvements, while worthwhile, are not sufficient to protect Medicare against continued program losses.

Although HCFA is aware that health care scams and abusive billing practices plague Medicare, the exploitation continues. HCFA's controls against fraud and abuse have not kept pace with health care's more complicated financial arrangements. Moreover, the broad discretion given to HCFA's claims processing contractors has resulted in uneven implementation of fraud and abuse controls. This problem has been compounded by HCFA's contractor management which, while improving, remains relatively weak.

As a result, HCFA does not have the information necessary to ensure that contractors are adequately protecting Medicare payments from provider exploitation or fraud. For example, HCFA cannot explain why some contractors pay many more claims for certain procedures than do other contractors because HCFA does not know what criteria its contractors use to identify claims ineligible for payment. In

addition, HCFA makes little use of management reports submitted by contractors that describe their claims review activities. For example, HCFA did not probe a contractor report that showed a 53 percent drop (amounting to nearly $27 million) in the amount of savings achieved through claims review.

Also, government funding of contractor fraud and abuse controls has not increased commensurate with the growing volume of claims—per claim funding for antifraud and antiabuse activities declined between 1989 and 1993 by 20 percent. Today Medicare pays more claims with less scrutiny than it did 6 years ago as shown in table 1.

Table 1: Medicare Claims Processed Versus Claims Reviewed

Year	Claims Processed	Claims Review Requirements
1989	483.5 million	20 percent
1994	735.7 million	5 percent

Reduced antifraud and antiabuse funding translates into greater Medicare losses. HCFA figures indicate that spending for antifraud and antiabuse activities can reduce Medicare program costs on average by 11 times the amount invested. By not adequately funding these activities, the federal government is

missing a significant opportunity to control Medicare program costs.

Medicare Claims high-risk issues are discussed in more detail in a separate report issued as part of this series (GAO/HR-95-8).

Minimizing Loan Program Losses

The federal government continues to be the nation's largest source of credit. In fiscal 1994, the government reported that it obligated almost $23 billion in new direct loans and guaranteed $204 billion in new non-federal lending. As of September 30, 1994, OMB estimated non-tax receivables, primarily direct loans and loans acquired as a result of claims paid on defaulted guaranteed loans, to be $241 billion. Of that amount, $50 billion was delinquent. The following three loan programs present high risks of losses.

High-Risk Loan Programs

Farm Loan Programs
Student Financial Aid Programs
HUD

Farm Loan Programs

Farm loan programs have evolved into a continuous source of credit for many borrowers and have had a high rate of loan defaults, which resulted in the loss of over $6 billion of taxpayers' money from fiscal years 1991 through 1994.[14] Although Farmers Home Administration (FmHA) has taken steps to correct some problems, little progress has been made in correcting other basic problems with farm loan programs.

On the positive side, field office lending officials have been provided with extensive training in credit and financial analysis to improve the quality of new loans being made. FmHA's reviews show that most new

[14]Within the U.S. Department of Agriculture, farm loans have been historically administered by FmHA. In October 1994, the responsibility was transferred to the newly created Consolidated Farm Service Agency. Because of the general familiarity with the agency's earlier name, we refer to FmHA in this report.

direct and guaranteed loans now meet lending standards. Also, compliance with standards for servicing guaranteed loans has recently improved.

However, field officials still do not always follow established procedures for servicing outstanding direct loans. In addition, neither Agriculture nor the Congress have addressed problems involving loan and property management policies; therefore, the agency, for example, continues to make loans to borrowers who either are delinquent or did not repay their previous debts, and reduce and forgive the debts of borrowers who do not repay their loans.

Even though FmHA forgave about $6 billion in unpaid loans from fiscal year 1991 through fiscal year 1994, its outstanding loan portfolio still contains nearly $5 billion in delinquent debt. We believe that FmHA needs firm guidance from the Congress on the acceptable level of loan losses and the length of time borrowers may receive farm loan assistance.

A separate report on **Farm Loan Programs** issued as part of this high-risk series offers additional information on FmHA's improvement efforts (GAO/HR-95-9).

Student Financial Aid Programs

Education's loan programs have generally succeeded in providing eligible students access to money for postsecondary education. However, largely due to structural problems, the programs have been costly—$2.4 billion in losses in the guaranteed student loan program alone in fiscal year 1994.

Education is taking action to address some of the guaranteed loan program's weaknesses, including transferring some of the program's risks and financial costs to lenders and guaranty agencies. As required by law, Education is also phasing down the guaranteed loan program and replacing it with a new direct loan program.

Despite improvement efforts, many of Education's problems with the guaranteed loan program continue. For example, we and the Education Inspector General could not attest to the accuracy of the guaranteed loan program's fiscal year 1992 or 1993 financial statements because of unreliable loan data.[15]

Some of Education's problems with the guaranteed loan program could also affect

[15]Financial Audit: Federal Family Education Loan Program's Financial Statements for Fiscal Years 1993 and 1992 (GAO/AIMD-94-131, June 30, 1994).

the direct loan and other student financial aid programs. For example, Education's loan data continue to be unreliable. Such information is needed to determine if ineligible students received additional financial aid or if the maximum allowable borrowing amount has been exceeded. Without this data, new financial assistance in the form of guaranteed loans, direct loans, or grants could be given to ineligible students. In addition, Education's problems with preventing unscrupulous schools from participating in the guaranteed loan program could surface in the new direct loan program as it is rapidly phased in—Education plans to go from just over 100 to about 1,400 participating schools in a single year. Without a viable strategy to guide the Department during this period of rapid growth, Education has put the new direct loan program at risk of not achieving its objectives efficiently and effectively.

Additional information on Education's improvement actions and its new direct loan program is given in a separate report on **Student Financial Aid** issued as part of this series (GAO/HR-95-10).

Department of Housing and Urban Development

Effectively managing HUD, which insures some $400 billion in housing loans, guarantees more than $400 billion in outstanding securities, and spends $25 billion a year on housing programs, has been hampered by four long-standing problems: (1) weak internal controls, (2) an ineffective organizational structure, (3) an insufficient mix of staff with the proper skills, and (4) inadequate information and financial management systems. Some of these problems were major factors leading to incidents of fraud, waste, abuse, and mismanagement reported in the late 1980s.

Important HUD initiatives to address these longstanding problems are either still in the planning stage or in the process of being implemented. It is much too early to assess their effectiveness.

Recently, HUD's Secretary announced a proposal to "reinvent" the agency over the next 4 years by consolidating its housing assistance and community development programs into three performance-based block grant funds, transforming public housing to make it more competitive, and changing the Federal Housing Administration into an entrepreneurial government-owned corporation. If

implemented, this proposal would shift many program design and implementation responsibilities to states and localities and would change HUD's primary role into that of overseer and information clearing house.

It is difficult to predict the impact of such sweeping changes on the corrective actions and plans that HUD already has under way. However, no matter what form HUD eventually takes, its fundamental weaknesses must be addressed. The current discussion on how best to "reinvent" HUD presents the agency, OMB, and the Congress with an excellent opportunity to work together to eliminate internal control, management, staffing, and systems problems.

Additional information on the **Department of Housing and Urban Development** improvement efforts can be found in a separate report being issued as part of this report series (GAO/HR-95-11).

Improving Management of Federal Contracts at Civilian Agencies

Civilian agencies spend tens of billions of dollars per year on contracts and have become increasingly dependent on contractors to help manage and carry out agency missions. However, once contracts

are awarded, federal agencies do not always effectively control contractors' costs and performance. At the core of contract management problems, we have found a lack of senior-level management attention to agencies' contracting activities. Our high-risk efforts will focus on three areas.

High-Risk Contracting Areas

Department of Energy
NASA
Superfund

Department of Energy

Energy spends about $15 billion annually through management and operating contracts. But its use of cost-reimbursement contracts, allowance of excessive contractor latitude, and inadequate oversight of contractor activities and costs have failed to protect the government from fraud, waste, abuse, and mismanagement. Energy did not require its contractors to prepare auditable financial statements, and the net

expenditures reports that contractors did prepare were not being audited every 5 years as required. Contractors were not able to provide consistent and reliable detailed cost information so that Energy managers could evaluate whether costs were reasonable and contractors were operating programs effectively. In addition, Energy's managers and staff have not received the data needed to determine the nature and extent of environmental contamination or to set priorities and monitor the progress of clean-up efforts.

In 1993, Energy began a comprehensive reform initiative. While Energy is still in the process of developing specific implementation plans, actions planned to date include using alternatives to cost-reimbursement contracts, increasing competition for contracts, strengthening financial information systems, and improving management and control of certain costs. Policy changes can be implemented almost immediately, but changes in regulations and procedures will take much longer. We are concerned, however, that staff training and information systems improvements are not scheduled to take place until most of the other contract reform initiatives have been implemented.

Energy's practice of introducing policies and reforms before staff are fully trained and systems fully developed has contributed to previous contract reform failures.

Energy has plans to include contractor operations in its agencywide financial statement audits; however, we doubt Energy's ability to accomplish such audits within the near future. Although Energy published its strategic plan for information management in July 1994, some actions will not be completed before fiscal year 1997.

Additional information on **Department of Energy Contract Management** problems and improvement initiatives can be found in the Quick Reference Guide (GAO/HR-95-2).

NASA

Despite recent improvement initiatives, NASA continues to struggle with the management of its contracts, valued at between $12 billion and $13 billion and representing about 90 percent of its funding.

Traditionally, NASA's contract management efforts have been hampered by

- procurements based on unrealistic funding expectations—its 1993 five-year budget

request totaled $90 billion, $20 billion more than was likely to be appropriated;

- the lack of adequate systems and information with which to monitor contractor activities; and
- field centers not adhering to contract management requirements.

Compounding NASA's inability to adequately oversee contractors has been its practice of assuming virtually all risk related to contract cost and results. This practice has contributed directly to frequent funding increases, schedule delays, and performance problems on many of NASA's large space projects.

NASA has been addressing its problems, but it is not yet clear whether its efforts will be effective. Also, additional efforts are needed. For example, NASA's new CFO must fill the financial leadership role and actively work towards the goals laid out in the CFO Act. Further, NASA needs to aggressively use its new authority to penalize contractors claiming reimbursement of unallowable costs.

Additional information on NASA **Contract Management** can be found in the Quick Reference Guide (GAO/HR-95-2).

Superfund

Since the Environmental Protection Agency's (EPA) Superfund program began in 1980, thousands of waste sites have been discovered, and their cleanup has proven far more complicated and costly than anticipated. Recent estimates indicate that cleaning up the thousands of hazardous waste sites—many of which are owned by the federal government—could result in over $300 billion in federal costs and many billions more in private expenditures.

Superfund relies heavily on contractors to perform cleanup work, but its extensive use of cost-reimbursable contracts give contractors little incentive to control costs. A recent review of three contractors showed that all three billed the government for entertainment, tickets for sporting events, or alcoholic beverage costs that either were not permitted or appeared questionable under applicable regulations. Furthermore, EPA's problems are compounded by backlogs of requests by procurement officials for audits to verify the accuracy of contractors' charges.

After years of giving insufficient attention to correcting known contract management problems, EPA management has begun focusing greater attention on better

controlling costs and other problems. However, little progress has been made in reducing the risk from insufficient or untimely audits. As of August 1994, there were 528 unfulfilled requests for audits of EPA contractor costs.

Additional information on EPA's **Superfund Program Management** improvement initiatives and remaining problems is provided in a separate report issued as part of this high-risk series (GAO/HR-95-12).

Implementing the Legislative Framework for Management Reform

A critical factor in resolving specific high-risk areas is addressing broader, more fundamental government management problems. A major breakthrough since the establishment of our high-risk program is the passage of legislation—the Government Performance and Results Act (GPRA) and the Chief Financial Officers (CFO) Act—that provide the structure necessary to help achieve improved government accountability and stewardship and to lower costs by focusing on results.

The Congress framed it this way: Set goals, operate programs, and measure results using reliable financial and management information. Effectively implementing this framework will require agencies to redirect the focus of management, substantially improve financial systems, and measure results.

Managing for Results

GPRA seeks to fundamentally change the focus of federal management and accountability from a preoccupation with inputs, such as program appropriations, to results and outcomes of federal programs. With successful implementation, this change can help address the question: What are the

American people getting for their investment in the federal government?

The experiences of state governments and foreign countries that are leaders in public management show that GPRA's three key elements—strategic planning, performance measurement, and public reporting and accountability—could influence the basic culture of government so that it is more results-oriented.[1] The Congress intends through GPRA to improve performance by providing managers freedom to experiment and find innovative ways to improve program results, while increasing their accountability for achieving those results.

GPRA requires an agency to do the following.

- Develop a 5-year strategic plan for its program activities by 1997, laying out the organization's fundamental mission and long-term goals and objectives for accomplishing that mission. To be updated every 3 years, this plan is to serve as the starting point and basic underpinning of the agency's goal-setting and performance measurement process.

[1]See, for example, Managing for Results: State Experiences Provide Insights for Federal Management Reforms (GAO/GGD-95-22, Dec. 21, 1994).

- Submit, beginning in 1999, annual program performance plans to OMB and subsequent program performance reports to the President and the Congress. OMB is to develop an overall federal government performance plan that is to be submitted annually to the Congress with the President's budget.

GPRA implementation began with performance planning and reporting pilots at selected agencies. Already, more than 70 programs and agencies have been designated as pilots, ranging in size from small programs to entire agencies, including IRS, the Social Security Administration, and the Defense Logistics Agency.

GPRA's vision of making major changes in the way federal agencies are managed and held accountable will require agencies to develop the capacity to manage for results. Currently, the lack of complete and reliable financial and other management information precludes many agencies from effectively measuring performance. Strong financial management systems and the aggressive use of information technology are preconditions for the success of GPRA.

This legislation requires us to report to the Congress on the implementation of the act, including the prospects that all federal agencies—even those not designated to do pilot projects—will comply with the act. Working with the Congress, we have designed a strategy for evaluating the pilots' implementation of results-oriented management that will identify the lessons learned from implementing GPRA as they happen.

Improving Financial Systems and Reports

Reliable financial information is key to better managing government programs, providing accountability, and addressing high-risk problems. However, as highlighted earlier in our discussions of a number of risk areas, the government's financial systems are all too often unable to perform the most rudimentary bookkeeping for organizations, many of which are oftentimes larger than many of the nation's largest private corporations.

Further, the government's financial systems are fast aging. About 30 percent of them were installed more than 5 years ago, and another 34 percent have already passed the 10-year mark. Agencies' antiquated financial systems simply do not adequately meet

critical requirements for comparable data and users' reporting needs. Also, OMB has reported that only one-half of agencies' financial management systems meet existing agency automated data processing technical standards, and a mere 2 percent comply with agencies' own targeted or planned technology standards.

Today's financial systems have no shortage of paper output but provide agency managers and the Congress little meaningful financial information. Greatly improved financial reporting is essential and would include

- financial information that is linked with program and budget data for use in both management control and planning,
- reports on program cost trends and other performance indicators from which managers can make informed decisions on running government operations effectively and efficiently, and
- financial data that is consistent and compatible and meets standard data requirements so consolidated financial reports will be useful.

Before 1990, this information was not required and the reliability of financial

information for only a minor part of the government's $1.5 trillion annual spending was independently checked. With passage of the CFO Act in 1990, the Congress paved the way for the federal government to have the same kind of financial statement reporting as required in the private sector and by state and local governments.

Under the 1990 act, financial statements prepared and audited as part of a pilot program involving 10 agencies have resulted in

- significantly more accurate and useful information on the government's financial status and its operations;
- a better understanding of the limited extent to which the Congress and program managers can rely on the financial information they receive, considering that almost all of the government's major departments and agencies have not been able to pass the test of an independent financial statement audit;
- substantial savings through the recovery and more efficient use of funds;
- a much better understanding of the extent and pervasive nature of internal control and financial management systems problems; and

- improvement in management's accountability for, and focus on, strong financial management.

In 1994, the Government Management Reform Act made the CFO Act's requirement for annual audited financial statements permanent and expanded it to cover the 24 major agencies that constitute virtually the entire executive branch budget, as shown in table 2.

Table 2: Agencies Required to Have Annual Audited Financial Statements

Agency/Department	1994 Outlays (in billions of dollars)	Percent of Total
HHS	278.9	17.6
Defense	299.0	18.9
Treasury	307.6	19.4
SSA	345.8	21.8
Agriculture	60.8	3.8
Labor	37.0	2.3
OPM	38.6	2.4
Veterans Affairs	37.4	2.4
Transportation	37.2	2.3
Education	24.7	1.6
HUD	25.8	1.6
Energy	17.8	1.1
NASA	13.7	0.9
Justice	10.0	0.6
Interior	6.9	0.4
EPA	5.9	0.4
AID	2.5	0.2
State	5.7	0.4
FEMA	4.2	0.3
Commerce	2.9	0.2
NSF	2.6	0.2
SBA	0.8	0.1
GSA	0.3	0.0
NRC	0.05	0.0
Total CFO Entities	**1,566.15**	**98.8**
Non-CFO Entities	**18.23**	**1.2**
Total Government	**1,584.38**	**100.0**

The act also requires the preparation of annual governmentwide financial statements to be audited by GAO and issued to the President and the Congress.

The CFO Act is a landmark in establishing accountability and is central to achieving management reform initiatives and solving high-risk problems. Effectively implementing this legislation must be a top priority of the administration, and continuing congressional oversight will be important to ensure results.

Foremost, inspectors general and agencies must ensure that the CFO Act's time frame for preparing audited financial statements for fiscal year 1996 does not slip. Also, agencies must

- give priority to implementing basic accounting practices, such as reconciliations;
- upgrade financial systems to meet reporting requirements and provide comparable data; and
- improve the capabilities of financial personnel.

To help accomplish the expanded CFO Act's objectives, we will initially focus our own audit efforts on the Departments of the

Treasury and Defense and review the work of the inspectors general and public accounting firms that will audit the rest of government. Within Treasury, we will audit (1) IRS, (2) the Bureau of the Public Debt, which is responsible for managing the over $4 trillion national debt, and (3) Treasury's Financial Management Service operations—the center of the government's trillion-dollar check paying and accounting operation. We plan to focus on Defense's departmentwide financial statements and, currently, we are auditing the Department of the Navy, which is among the largest and most complex federal agencies.

We are closely working with the Department of the Treasury and others as they develop governmentwide financial statements, which we will audit annually. Ultimately, these reports will, for the first time, give the President and the Congress an overall and complete picture of where the government stands financially.

CFO Act and GPRA Results Will Be a Cornerstone for Our High-Risk Program

Together, the CFO Act and GPRA requirements provide an important means to transform the way the federal government is managed and a powerful incentive to improve data and management controls. We will use the

results of CFO Act financial audits and agencies' GPRA programs to help identify high-risk areas and assess agencies' progress to resolve them. Ultimately, the full implementation of these laws will provide heightened emphasis on effectively managing government programs and overcoming high-risk problems.

Key Contacts for Newly Designated High-Risk Areas

Defense Financial Management	David Connor, Director Defense Audits Accounting and Information Management Division 202-512-9095
Defense Corporate Information Management (CIM) Initiative	Jack Brock, Director Information Resources Management—Defense Accounting and Information Management Division 202-512-6240 Donna Heivilin, Director Defense Management and NASA National Security and International Affairs Division 202-512-8412
IRS Financial Management	Gregory Holloway, Director Civil Audits—General Government Accounting and Information Management Division 202-512-9510

IRS Filing Fraud	Jennie S. Stathis, Director Tax Policy and Administration Issues General Government Division 202-512-5407
IRS Tax Systems Modernization (TSM) Initiative	Hazel Edwards, Director Information Resources Management—General Government Accounting and Information Management Division 202-512-6418
FAA Air Traffic Control Modernization and National Weather Service Modernization	Joel Willemssen, Director Information Resources Management—Resources, Community, and Economic Development Accounting and Information Management Division 202-512-6416

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